

ORIGINAL

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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In the Matter of

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1997 Annual Access Tariff Filings

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CC Docket No. 97-149

REBUTTAL OF U S WEST COMMUNICATIONS, INC.
TO OPPOSITIONS TO DIRECT CASE

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September 24, 1997

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SUMMARY

In this proceeding, AT&T and MCI have raised several issues regarding the annual access tariff filing of U S WEST. Most notably, AT&T and MCI claim that U S WEST, and the other price cap LECs, have used a defective methodology that underestimates their BFP for the tariff year, which has the effect of understating EUCL charges and overstating CCL charges. They ask the Commission to recalculate the LECs' CCL charges by forecasting BFP on the basis of historical data. They would have the Commission recalculate CCL charges on the assumption that the LECs' BFP forecasts in prior years were equal to actual results.

Whatever the merits of implementing such an error-correction mechanism, it is contrary to the Commission's present rules, which require price cap LECs to "project" their BFP, and which require the LECs to use no specific methodology. If the Commission wishes to implement the use of such a methodology, it may do so only prospectively.

Without an error-correction feature, AT&T's proposal becomes simply another method of forecasting BFP. AT&T makes no claim that such a methodology will produce more accurate projections than the LECs' existing methods, and the available evidence would suggest that it will not. Moreover, for the Commission now to require a specific methodology requires a rule change, which the Commission may not implement in this proceeding, and certainly not retroactively.

In any case, changes to the structure of access charges to become effective January 1, 1998 will overshadow any change the Commission might order here.

Those January changes will send all EUCL charges to cap, or very near it, regardless of BFP.

AT&T claims, without evidence or argument, that U S WEST understated its reported BFP for calendar years 1995 and 1996. We will show the error of this claim.

AT&T and MCI contend that U S WEST, and most other price cap LECs, have understated the exogenous cost adjustment necessary to remove equal access cost recovery from their PCIs. Specifically, they claim U S WEST erred by reducing the adjustment to reflect PCI declines over the years and by not increasing the adjustment to reflect growth in revenues, even though the Commission has not required such an adjustment in prior similar situations. The changes requested by AT&T and MCI attempt to forge an inappropriate link between costs and prices. They are thus inconsistent with the theory underlying price caps.

Finally, AT&T and MCI claim that U S WEST has engaged in retroactive rate making in its treatment of OB&C charges. They are incorrect; U S WEST's approach to this issue is not materially different from other exogenous changes the Commission has required over the years.

In the Matter of)
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1997 Annual Access Tariff Filings) CC Docket No. 97-149

U S WEST Communications, Inc. ("U S WEST") hereby submits this Reply to the Oppositions filed herein by AT&T Corp. ("AT&T") and MCI Telecommunications Corporation ("MCI").

¹ AT&T at iii-iv. The changes to the price cap regime implemented by the Commission's Price Cap Order and its Access Charge Reform Order, along with the advent of local competition, will bring about further, substantial reductions in access charges in coming years, regardless of anything the Commission might do in this proceeding. In the Matter of Price Cap Performance Review for Local Exchange Carriers, CC Docket Nos. 94-1 and 96-262, Fourth Report and Order in CC Docket No. 94-1 and Second Report and Order in CC Docket No. 96-262, 8 Comm. Reg. (P&F) 119 (1997), appeals pending sub noms. United States Telephone Association, et al. v. FCC, Nos. 97-1469, et al. (D.C. Cir.) ("Price Cap Order"). In the Matter of Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Transport Rate Structure and Pricing; End User Common Line Charges, CC Docket Nos. 96-262, 94-1, 91-213, 95-72, First Report and Order, 7 Comm. Reg. (P&F) 1209 (1997), appeals pending sub noms. Southwestern Bell Telephone Company, et al. v. FCC, Nos. 97-2618, et al. (8th Cir.) ("Access Charge Reform Order").

that the Commission would order reductions totaling \$1.7 billion. AT&T has lowered its basic rates – as it promised to do if the Commission ordered access charge reductions meeting its expectations – and it now expects the Commission to fulfill its end of the bargain.

In demanding further access reductions, AT&T asks the Commission to set aside principle in favor of results. It seeks to have the Commission apply an unproven method of “forecasting” the price cap local exchange carriers’ (“LEC”) base factor portion (“BFP”) that contradicts the spirit, if not the letter, of existing Commission rules. It seeks, moreover, to have the Commission apply this method to previous LEC forecasts to wring out the supposed effects of errors in previous BFP forecasts. As a result, AT&T’s forecasting methodology becomes no forecast at all. It is an attempt to derive a BFP solely on the basis of historical information, a method contrary to the spirit – if not the letter – of the Commission’s rules.

AT&T is free to disregard principle in its drive for a specific result, but the Commission may not. If it wishes to require the LECs to use a specific methodology to develop their BFPs, it may do so prospectively only. Given the existing rules and the long history of unchallenged LEC forecasts, a sudden, retroactive change of course would be fundamentally unfair to the LECs and their multi-line business customers, who must shoulder the burden of increased rates to give AT&T its expected additional access charge reductions.

As to the LEC BFP forecasts, this Rebuttal will demonstrate –

- that the “forecasting” methodology advocated by AT&T is contrary to the intent of the Commission’s rules;

- that AT&T's method is no more likely to generate an accurate forecast than the methods utilized by the LECs; and
- that changes to be implemented to the access charge structure on January 1, 1998, will alter the processes at issue, and the Commission should avoid making changes that will have only a temporary effect.

AT&T and MCI thus provide no good reason to change existing procedures. There is, we believe, every reason not to order a change, or to order it only on a prospective basis.

AT&T and MCI complain about the method used by most LECs to remove the effects of equal access cost recovery from their price cap indices ("PCI"). They also argue that U S WEST has improperly included recovery of its Other Billing and Collection ("OB&C") costs incurred during the two months prior to the effective date of the tariffs at issue here. AT&T and MCI are wrong on both counts.

I. THE COMMISSION SHOULD NOT DIRECT A CHANGE TO THE BFP FORECASTING METHODOLOGIES UTILIZED BY THE PRICE CAP LECS

The Commission's rules generally require LECs to compute the end user common line ("EUCL") charge –

by dividing one-twelfth of the projected annual revenue requirement for the End User Common Line element by the projected average number of local exchange service subscriber lines in use during such annual period.²

The EUCL revenue requirement is a portion of the overall Common Line revenue requirement, and is also referred to as the "base factor portion" or BFP.³

² 47 C.F.R. § 69.104(c) (emphasis supplied).

³ 47 C.F.R. § 69.501(e).

The Commission has capped the EUCL charge, and any EUCL revenue requirement not recovered through EUCL charges is recovered in the form of the carrier common line (“CCL”) charges imposed on interexchange carriers (“IXC”).⁴ The EUCL charge on residence and single-line business lines is limited to no more than \$3.50 per line per month. The Commission had previously capped the EUCL charge for multi-line business lines at \$6; with this filing, however, the multi-line business EUCL cap increased to \$9. And that is the source of the controversy here.

The EUCL charge for residence and single-line business lines is set at the cap in every U S WEST state. Until the 1997-98 tariff year, the EUCL charge for multi-line business lines was at or near cap in most states. Because of this, increasing a LEC’s projected BFP could have only a small effect on its actual EUCL charges. More to the point, that projection had little or no effect on the CCL charge because it had little impact on the portion of the Common Line revenue requirement actually recovered by means of EUCL charges. Thus, in all the years in which U S WEST has been subject to price caps, its forecast of BFP has been wholly non-controversial.

Until now. By increasing the EUCL cap for multi-line business lines to \$9, the Commission has opened a spread between the cap and the EUCL charge in most states. If the affected LECs were to increase their EUCL charges, they would thereby increase the portion of the Common Line revenue requirement paid by end users and decrease the amount paid by IXCs through the CCL charge. That is, if

⁴ 47 C.F.R. § 69.502.

AT&T and MCI can convince the Commission to increase the LECs' BFP projections, thus increasing their multi-line business EUCL charges, they will thereby obtain reductions in the CCL charges they pay the affected LECs.

Thus, though U S WEST has used – without significant objection – virtually the same methodology to project its BFP since the beginning of price caps over six years ago, it now finds its BFP projections analyzed and criticized in excruciating detail. That analysis and criticism covers not just the BFP projection supporting U S WEST's 1997 annual access tariff filing, but extends as well to every BFP projection since the beginning of price caps.

In each annual filing, U S WEST has projected its BFP for each of its 14 states by using budget data. U S WEST first calculates a BFP for the prior calendar year. It then subjects the various elements of the BFP to 18-month, subject-to-separations growth factors, calculated by reference to budget data for the base year and succeeding years to generate a projected BFP for the coming tariff year.

Virtually no forecast, however derived, will predict future events with complete accuracy. U S WEST's BFP projections are not different. As explained in U S WEST's Direct Case, however, U S WEST's BFP projections have differed from actual results primarily because U S WEST's region has seen several years of unprecedented economic growth in recent years, and that has produced unexpected growth in cable and wire circuit investment. This continued boom contradicts long-term historical trends, which show that U S WEST's region has traditionally lagged the national economy. U S WEST's BFP projections from 1994 on have also

reflected U S WEST's aggressive program of selling certain rural exchanges.

U S WEST's budgets have projected the effects of these sales, but all of them have taken much longer than anticipated. As a result of these phenomena, U S WEST's BFP projections have fallen short of its actual BFP by greater margins in the past few tariff years.

A. AT&T's Method For "Projecting" The Price Cap LECs' BFPs
Runs Contrary To The Spirit, If Not The Letter, Of The
Commission's Rules

The Commission's rules "do not prescribe a BFP forecasting methodology."⁵

Despite this, AT&T asks the Commission to prescribe a methodology and to do so retroactively. Thus AT&T tells us –

LECs should calculate their BFP and EUCL line forecasts by constructing a trend-line based on their adjusted actual historical calendar-year data. . . .

For each projection period, LECs should also be required to adjust their projections to account for the difference between the actual and forecasted BFP revenue requirement and EUCL lines for the previous period. Including this "error-correction" in the forecasting methodology will ensure that past under/over forecasting errors will not become permanently embedded in the rates and will be removed as soon as possible.⁶

AT&T's reference to a "trend line" is somewhat misleading, in that AT&T has used a simple five-year average growth rate in calendar-year BFPs to calculate a BFP for

⁵ In the Matter of 1997 Annual Access Tariff Filings, National Exchange Carrier Association Universal Service Fund and Lifeline Assistance Rates, CC Docket No. 97-149, Transmittal No. 759, Memorandum Opinion and Order, DA 97-1350, rel. June 27, 1997 ¶ 21 ("Suspension Order").

⁶ AT&T at 14-15.

each LEC for tariff year 1997-98.⁷ Specifically, AT&T would increase the actual BFP for the prior calendar year by one and one-half times the average increase in the BFP over the prior five years; AT&T increases the average growth rate by half in order to account for the fact that the tariff year under consideration will end 18 months after the conclusion of the calendar year.

As we will demonstrate below, there is no reason to assume (AT&T provides no proof) that this will produce a more-reliable forecast of a LEC's BFP in any given tariff year. That does not concern AT&T, however, because it would have the Commission institute an "error-correction" device to fine tune the LECs' filed BFPs.

This might well be a reasonable means of calculating the BFP for the short period it is likely to be relevant,⁸ but it is not consistent with the Commission's existing rules, which do not prescribe a methodology. If the Commission wishes now to prescribe a methodology, it must undertake a rule change by means of a rulemaking proceeding. At the very least, the Commission may not implement such a change retroactively.

AT&T's methodology is further inconsistent with the Commission's rules in that the product of the methodology is not a forecast, in any meaningful sense. As noted, the Commission's rules require the price cap LECs to "project" their BFP. The dictionary defines this term, in the relevant sense, as "to plan, figure, or

⁷ Id., Appendix B at 4.

⁸ As we explain below, the changes the Commission has directed to be implemented on January 1, 1998, will likely cause the BFP calculation to return to its prior obscurity.

estimate for the future.”⁹ AT&T’s error-correction methodology removes all the uncertainty inherent in forecasting, as most people would view that concept. It is, moreover, wholly inconsistent with the way the industry has interpreted the Commission’s rules in their annual filings over the years, and the Commission has allowed the rates based on those interpretations to go into effect. The Commission cannot blithely ignore this history. If it wishes the LECs to utilize something other than a projection to calculate BFP, it must institute that change prospectively by means of a rulemaking proceeding. Applying an error-correction approach to rates that have been in effect for some months – albeit subject to an accounting order – would unfairly deprive the LECs of revenues they are lawfully entitled to, or produce massive customer dissatisfaction.¹⁰ AT&T and MCI win either way. They receive lower CCL rates and perhaps a refund, and even if the LECs are allowed to recoup the revenues through higher EUCL charges on large business customers, the resulting customer dissatisfaction will aid AT&T and MCI in winning these highly desirable customers to their local service.

Thus the Commission must reject AT&T’s call for an error-correction mechanism in this proceeding.

⁹ Webster’s Ninth New Collegiate Dictionary, Merriam-Webster (1987), p. 940.

¹⁰ If the LECs were required to recalculate their CCL rates back to July 1, but were not also allowed to recalculate their EUCL rates, they would lose revenues they would otherwise be entitled to collect because of a de facto rule change they could not reasonably have foreseen. But raising EUCL rates retroactively for customers who have already experienced an increase on July 1, and who will see yet another increase on January 1, would trigger immense customer dissatisfaction.

B. Absent An Error-Correction Mechanism, AT&T's Methodology Is Unlikely To Project A LEC's BFP With Any Greater Accuracy Than The LECs' Existing Methodologies

Without an error-correction mechanism, AT&T's proposal simply becomes a request that the Commission require the LECs to project their BFPs using the average BFP growth rate for some number of prior calendar years. AT&T's proposal would remove much of the contention from future BFP filings; if the Commission were to prescribe how the LECs must calculate BFP, no one could argue with the LECs' use of that methodology.

As noted above, however, the Commission's rules prescribe no methodology for forecasting BFP. If the Commission wishes now to prescribe the methodology advocated by AT&T, or some other method, it must change its rules by means of a rulemaking proceeding. At the very least, the Commission may not order such a change retroactively.

Moreover, nothing in AT&T's Opposition suggests – let alone proves – that this methodology would necessarily produce a more accurate projection for any particular tariff year than do the LECs' current methods.¹¹ The available evidence would indeed suggest that it is no more likely to produce an accurate forecast.

U S WEST and AT&T use the same starting point to develop a BFP projection for tariff year 1997-98. That is, both begin with the actual BFP for calendar 1996, the most recent full year available at the time the projection must be

¹¹ A rulemaking would enable the Commission to weigh AT&T's method and assess its merits against other proposals. A tariff review proceeding is not the proper venue to institute a rule change.

made. Both then adjust that actual BFP to reach an estimate of the tariff-year BFP. AT&T would determine the appropriate adjustment mechanically, by simply averaging five years of growth statistics. U S WEST utilizes the best information available regarding the future – its budgets – to compute BFP growth for each of its 14 states for the next tariff year.

AT&T and MCI have said much about the inaccuracies of U S WEST's and the other LECs' forecasting. AT&T says nothing about the accuracy of the forecasts its method (without an error-correction mechanism) would produce, and for good reason: we will not know until the end of the current tariff year how accurately AT&T has projected the LECs' BFPs.

We can, however, get some idea of the accuracy of this methodology by using it to "project" the Bell Operating Companies' ("BOC") BFPs for the 1992-93 through 1996-97 tariff years. That is, we can use the average growth in BFP for the calendar years 1991 through 1996 to calculate BFPs for these five tariff years, just as AT&T calculated BFPs for the current tariff year. This uses the average to "project" essentially the history that goes into the average itself, and it thus should be more accurate than it would when used to project the future. And yet, Appendix A demonstrates that AT&T's methodology is no more likely to "project" an accurate BFP for any particular year in this historic period than did the BOCs' methodologies, which were always applied to an unknown future. Specifically, AT&T's method "projected" the BFP more accurately than the BOCs did on 20 of 40

observations¹² – exactly half the time. Perhaps it would do better projecting the future, but we have no reason to believe so, and it seems highly unlikely.¹³

Thus, unless the Commission incorporates an error-correction mechanism – and we do not believe it can do so retroactively – there is no good reason (aside from the administrative benefits of certainty) to adopt AT&T's forecasting methodology.

C. In Light Of Changes To Be Implemented On January 1, 1998, The Commission Should Not Order A Change In BFP Methodology For The Current Tariff Year

There is yet another reason that the Commission should not require changes to the BFP projections filed by the price cap LECs. On January 1, several changes ordered by the Commission in the Access Charge Reform Order will take effect.

These changes will cause the LECs' EUCL rates to increase. Specifically –

- Line port costs now recovered in the local switching rate will be recovered in Common Line rates (EUCL charges, to the extent caps permit; then Primary Interexchange Carrier charges ("PICC"), to the extent caps permit; then CCL charges).¹⁴
- Marketing expenses currently recovered in the Common Line, Traffic Sensitive and Trunking baskets will be recovered through the EUCL charge imposed on non-primary residence lines and on multi-line business lines, to the extent caps permit.¹⁵
- Long Term Support (recovered in Common Line rates) will be replaced by the higher Universal Service Fund Support.¹⁶

¹² Eight BOCs (including Nevada Bell) for five tariff years.

¹³ This is particularly true given the volatility of BFP growth. From 1989 to 1996, U S WEST's calendar-year BFP growth ranged from zero to 10%. Other companies had even greater volatility.

¹⁴ Access Charge Reform Order, 7 Comm. Reg. (P&F) at 1245-46 ¶ 125.

¹⁵ Id. at 1230 ¶ 66, 1292-94 ¶¶ 319-24.

¹⁶ Id. at 1306-7 ¶ 379.

Even absent a Commission-ordered change to U S WEST's filed BFP, these changes will, in all probability, drive U S WEST's EUCL rates, other than multi-line business, to cap in all its states; U S WEST's multi-line business EUCL will likely be at cap in half its states, and near cap in the rest.

Given the advent of these events, U S WEST believes the BFP issue will essentially become moot on January 1. We thus believe the Commission would do better simply to leave the situation as is; a prospective rate change would be effective for only a very short period of time.

D. U S WEST Properly Calculated Its 1995 And 1996
Calendar-Year BFPs

Though it provides no argument or analysis, AT&T claims – in a footnote to an Appendix to its Opposition¹⁷ – that U S WEST miscalculated its 1995 and 1996 BFPs by excluding “RAO 20” costs. AT&T is incorrect.

In the RAO 20 Order, the Common Carrier Bureau (“Bureau”) prescribed certain accounting treatment for postretirement benefits other than pensions (“OPEB”).¹⁸ On review, the Commission determined that the Bureau had exceeded its delegated authority in directing certain exclusions from and additions to the affected carriers’ rate bases; the Commission thus “rescinded” that portion of RAO 20.¹⁹

¹⁷ AT&T, Appendix B at 4, n.2.

¹⁸ Uniform Accounting for Postretirement Benefits Other Than Pensions in Part 32, 7 FCC Rcd. 2872 (CCB 1992) (“RAO 20”).

¹⁹ In the Matter of Responsible Accounting Officer Letter 20, Uniform Accounting for Postretirement Benefits Other Than Pensions in Part 32; Amendments to Part 65.

In calculating its BFP for 1995 and 1996, U S WEST did not abide by these RAO 20 requirements; that is, it calculated its BFP as though the subsequently-rescinded portions of RAO 20 had never existed. For reasons it makes no effort to explain, AT&T apparently believes U S WEST should have followed the dictates of RAO 20. But the Commission held that the Bureau was without authority to issue this portion of RAO 20; that Order thus had no validity from its inception, and U S WEST properly disregarded it.

II. U S WEST CORRECTLY CALCULATED THE ADJUSTMENT TO REMOVE EQUAL ACCESS COST RECOVERY FROM ITS ACCESS CHARGES

In the Access Charge Reform Order, the Commission required the price cap LECs to make a downward exogenous cost adjustment to their PCIs to account for the completion of the amortization of equal access non-capitalized expenses.²⁰ To implement this requirement, U S WEST determined the non-capitalized portion of the equal access expense as of year-end 1990, which was immediately prior to implementation of the first price cap rates. U S WEST added to that amount a return (at 11.25%) on the average deferred interstate balance and grossed up that return for taxes. U S WEST then reduced this sum to reflect the reduction in its Local Switching PCI since the time the rates came under price caps. It reduced its Local Switching PCI by the resulting amount, some \$4.8 million.

Interstate Rate of Return Prescription Procedures and Methodologies, Subpart G, Rate Base, Memorandum Opinion and Order and Notice of Proposed Rulemaking, 11 FCC Rcd. 2957, 2961 ¶ 25 (1996).

²⁰ Access Charge Reform Order, 7 Comm. Reg. (P&F) at 1293 ¶¶ 320-24.

AT&T and MCI dispute U S WEST's calculation in two respects.²¹ They claim the exogenous adjustment should not reflect PCI reductions, but that it should be increased to reflect revenue growth ("R" value).²²

In implementing price caps, the Commission disconnected the affected LECs' prices from their costs. To be sure, that separation was never complete, as witnessed by the exogenous cost changes required by the price cap rules, but the Commission should avoid steps that would unnecessarily bring the two back together again. Making the "R" adjustment demanded by AT&T and MCI would involve just that sort of unnecessary relationship. Attributing revenue growth to costs incurred years before is a meaningless concept with no basis in reality.

Under price caps, "R" is a function of rates and demand. Prices (and thus revenues) no longer have a direct relationship to costs, as they did under rate-of-return regulation. When the equal access charge was removed from the LECs' rate structures, U S WEST had nearly \$23 million headroom in its Traffic Sensitive Basket, and ample headroom in the Local Switching Category, in which the equal access charge resided. If the Commission had ordered this exogenous change at that time, U S WEST could have implemented it without reducing any rates. Its "R" value would then have grown to where it is today, despite this (hypothetical) exogenous cost change. "R" has, at best, only a tenuous relationship to cost, and

²¹ AT&T at 16-24; MCI at 9-13.

²² Curiously, when AT&T first proposed this adjustment, it proposed to calculate it using the same methodology that U S WEST used, and reached very nearly the same result. Comments of AT&T, CC Docket No. 96-262, filed Jan. 29, 1997 at Appendix F. AT&T does not explain why it changed its position on this matter.

frequently no relationship at all. By arguing for an “R” adjustment, AT&T and MCI are attempting to restore a direct link between cost and revenue, a link that has long since disappeared.

In implementing other, similar exogenous changes, the price cap LECs (including U S WEST) have removed the costs at the level they were initially incurred, without adjusting them for the growth in “R”. For example, when the Commission ordered exogenous cost changes to remove the effects of the inside wire amortization and the depreciation reserve deficiency amortization, it did not require the LECs to increase the adjustment by the growth in “R”, and U S WEST made no such adjustment.

AT&T and MCI do not challenge this, but they claim those exogenous changes were different because they involved annual downward changes, rather than a single change.²³ That, however, is a difference only in degree. It would affect the amount of the “R” adjustment, not the necessity of making the adjustment in the first instance. Moreover, the required exogenous adjustments for the completion of the depreciation reserve deficiencies,²⁴ the completion of the inside wire amortization,²⁵ and now the completion of the equal access expense amortization²⁶ are all part of the same rule. That rule does not prescribe different treatment for the various categories of exogenous adjustments. Finally, when the

²³ AT&T at 23; MCI at 13.

²⁴ 47 C.F.R. § 61.45(d)(1)(i).

²⁵ 47 C.F.R. § 61.45(d)(1)(viii).

²⁶ 47 C.F.R. § 61.45(d)(1)(ix).

Commission ordered the removal of the equal access amortization, it specifically stated that it would –

accord the expiration of equal access cost amortizations the same exogenous cost treatment given to the amortizations of the depreciation reserve deficiencies and inside wiring costs.²⁷

The Commission has thus required the price cap LECs to make this exogenous change just as they made the others, without an adjustment for “R”.²⁸

AT&T also objects to U S WEST’s adjusting the exogenous change to reflect PCI reductions.²⁹ That adjustment is necessary, however, to maintain the separation between prices and costs, a principle of price caps. Though the costs at issue played some role in the development of the rates in effect when price caps took effect, that connection has become attenuated over time, as PCI reductions brought about reductions in the LECs’ rates, without regard to the changes in their costs. There is no way to measure this attenuation with any precision, but the intervening PCI changes provide a reasonable proxy. Without this adjustment, the Commission would be articulating a much stronger price-cost connection than the facts warrant. Moreover, the Commission accepted the same sort of adjustment in U S WEST’s

²⁷ Access Charge Reform Order, 7 Comm. Reg. (P&F) at 1291 ¶ 310 (emphasis supplied).

²⁸ AT&T cites (at 20-21, n.29) Commission decisions requiring an “R” adjustment in removing the effects of an exogenous change for sharing. In that situation, specifically-identified exogenous costs have been added to the PCI and now must be removed. The impact of those costs on rates is more readily determined. Here, by contrast, we have costs that went into setting rates long before the inception of price caps. Whatever impact these costs might have had on those rates then has disappeared over time, given the general disconnection of prices from costs during the price cap regime.

²⁹ AT&T at 21.

filing to remove payphone costs from the CCL charge.³⁰ That aspect of the payphone filing indeed provoked no controversy.³¹

Given all this, U S WEST submits that it made this exogenous adjustment properly, and the Commission should not require a further change.

III. U S WEST'S RECOVERY OF OB&C REVENUES IS NOT RETROACTIVE RATEMAKING

Effective May 1, 1997, the Commission changed the separations rules applicable to OB&C expense.³² The OB&C Order had the effect of increasing U S WEST's interstate costs, and it is thus entitled to an exogenous cost adjustment to the applicable PCI.³³ U S WEST chose, however, not to make a separate tariff filing to implement that exogenous change on May 1. Recognizing that it would be making the annual access tariff filing at about the same time, that the annual filing would take effect two months after the effective date of the separations change, and that the amount at issue is relatively small (something over \$400 thousand per month), U S WEST elected to hold off making this exogenous change. Thus U S WEST's annual filing included an exogenous change to recover 14 months of the additional costs during the 1997-98 tariff year.

³⁰ U S WEST Communications, Transmittal No. 23, Tariff FCC No. 5, effective Apr. 15, 1997.

³¹ And, as noted above, AT&T proposed the very same adjustment in requesting an exogenous change to remove the effects of equal access cost recovery.

³² In the Matter of Amendment of Part 36 of The Commission's Rules and Establishment of a Joint Board, Report and Order, 12 FCC Rcd. 2679 (1997) ("OB&C Order").

³³ 47 C.F.R. §§ 61.45(d)(1)(iii), 61.44(c)(3).

The Suspension Order questioned the lawfulness of U S WEST's choice,³⁴ and AT&T and MCI now claim that U S WEST has engaged in retroactive ratemaking. They are wrong.

The retroactive ratemaking doctrine is a corollary of the filed rate doctrine. It prohibits a regulatory agency from requiring or allowing a carrier to adjust its current rates to recoup an over- or under-recovery from prior approved rates. That is, if a carrier's approved rate does not provide sufficient revenues, it cannot raise future rates to recover the shortfall.³⁵

U S WEST is not attempting to recover a shortfall caused by an inadequate prior rate; there was no prior rate. Rather, U S WEST is attempting to recover an exogenous cost in its new rates, as permitted by the Commission's rules. Nothing in those rules dictates that such costs must be recovered over a particular period of time. Given the amounts involved, U S WEST's decision, which spared it and the Commission the trouble of a tariff filing that would have been effective for only two months, was eminently reasonable.

If AT&T and MCI were correct, the Commission could never order or allow a price cap LEC to make an exogenous change reflecting events from a prior tariff year. Yet, the Commission's rules permit this, and the Commission has frequently

³⁴ Suspension Order ¶¶ 47-8, 51. The Designation Order also questioned certain aspects of U S WEST's calculation of its exogenous cost change. In the Matter of 1997 Annual Access Tariff Filings, Order Designating Issues for Investigation, CC Docket No. 97-149, Memorandum Opinion and Order on Reconsideration, DA 97-1609, rel. July 28, 1997 ¶ 47 ("Designation Order"). U S WEST pledged in its Direct Case (at 36) to correct the errors, and it will do so.

allowed a price cap carrier to adjust its PCI to reflect costs incurred in a prior period. For example:

- The amortization of depreciation reserve deficiencies reflects capital costs incurred many years in the past and depreciation expenses that should have been, but were not, recovered over the intervening years.
- U S WEST has filed its Regulatory Fee adjustments at various points in the year and recovered them over however many months remained in the tariff year.
- In its 1996 Annual Filing, U S WEST made an exogenous change to recover contributions to Telecommunications Relay Service that it had made over a year before; no party objected, and the Commission allowed the exogenous change.
- The 1995 tariff year began on August 1, rather than the normal July 1. The price cap LECs were allowed to recover exogenous costs over the eleven months of the tariff “year;” they were not required to forego the revenue not collected during July.

What U S WEST has done with its OB&C costs is not different from these examples, and it is not retroactive ratemaking.

IV. CONCLUSION


For the reasons stated, the Commission should reject AT&T’s proposed methodology for determining BFP; at a minimum, the Commission should require

³⁵ E.g., In the Matter of Price Cap Performance Review for Local Exchange Carriers, First Report and Order, 10 FCC Rcd. 8961, 9071-72 ¶ 252 (1995).

the use of this methodology only prospectively. The Commission should approve U S WEST's exogenous cost change to remove the effects of the amortization of equal access expenses as filed by U S WEST. The Commission should also approve U S WEST's exogenous cost change to account for the changes to OB&C as filed by U S WEST.

Respectfully submitted,

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September 24, 1997

Appendix A

An Analysis of AT&T's Forecasting Methodology

This Appendix “forecasts” the BFP for each of the eight BOCs (including Nevada Bell) for the tariff years 1992-93 through 1996-97 using the methodology utilized by AT&T to forecast the BOCs’ BFPs for 1997-98. It then compares these “forecasts” to the actual BFP for each tariff year and calculates the error (as a percentage of actual BFP) for each year. The Appendix then provides the BOCs’ forecasts for each year, also as reported by AT&T, and calculates the error for each such forecast.

The Appendix displays the BFP for each calendar year from 1991 through 1996, the growth rate for each year, and the average of those growth rates, all as reported by AT&T (except that U S WEST’s BFPs for 1995 and 1996 are as reported by U S WEST in its Direct Case). To calculate a forecasted BFP for the tariff year 1997-98, AT&T increased the calendar 1996 BFP by one and one-half times the average growth.

The Appendix replicates this methodology. For each BOC, it develops a “Factor” equal to one plus 1.5 times the average growth rate. It then calculates the BFP for a tariff year by multiplying the BFP for the prior calendar year by the Factor. For example, to calculate the 1992-93 BFP forecast, the Appendix multiplies the BFP for calendar 1991 by the Factor.

Of the forty observations (eight BOCs for five tariff years), AT&T’s method “forecasts” the BFP more accurately than the BOC’s actual forecast twenty times – exactly half. The BOC’s forecast was more accurate for the other twenty observations.